

RATING REPORT

Quality Textile Mills Limited

REPORT DATE:

December 30, 2022

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	BBB	A-2	BBB	A-2
<i>Rating Date</i>	<i>December 30, 2022</i>		<i>December 30, 2021</i>	
Rating Outlook	Negative		Stable	
Rating Action	Maintained		Initial	

COMPANY INFORMATION

Incorporated in 1988	External auditors: A.D Akhawala & Co. Chartered Accountants
Public Unlisted Company	Chairman: Mr. Noor Muhammad Hashim
Key Shareholder (s):	CEO: Mr. Tayyab Noor Muhammad
<i>Mr. Noor Muhammad Hashim – 45.7%</i> <i>Mr. Tayyab Noor Muhammad – 35.0%</i> <i>Ms. Ambreen Noor Muhammad – 11.1%</i>	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates (August 2021)

<https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf>

Quality Textile Mills Limited

**OVERVIEW
OF THE
INSTITUTION**

RATING RATIONALE

Quality Textile Mills Limited was incorporated in Pakistan on May 03, 1998 as a public limited company under the repealed Companies Ordinance, 1984 (Repealed with the enactment of the Companies Act, 2017)

Profile of Chairman

Mr. Noor Muhammad Hashim is one the founding director of Quality Textile Mills Limited. He possess over 43 years of experience of business in various fields. In 1969, he started 3S dealership of Toyota with the name of M/s Pakistan Motors Ltd. In the year 1981, he further acquired 3S dealership of Nissan with the name of M/s Fadoo Automobile Ltd. In 1985, he ventured in the field of Activated Bleaching Earth chemicals and laid foundation of M/s Pakistan National Chemical Ind. Ltd. Following his strategy of diversification in 1988, he started a textile-spinning mill with the name of M/s Quality Textile Mills Limited.

Profile of CEO

Mr. Tayyab Noor Muhammad is the executive director of Quality Textile Mills Limited since 2004. He

Company Overview

Incorporated in 1988, Quality Textile Mills Limited’s (‘QTML’ or ‘the Company’) principal activity involves manufacture and sale of yarn. It is an ISO certified cotton spinner.

Production plant of QTML has 25,104 spindles with capacity utilization has been reported on the higher side historically. In FY22, 1,200 rotors were installed as part of capacity enhancement plan yielding greater flexibility in types of yarn. Further, in the outgoing year waste processing plant of the entity become operational, the output of which is planned to be utilized internally. In line with a fall in demand on the back of slowdown in the global economy, the plant currently operates at 50% utilization. The setup of rotors that is used to manufacture cheaper yarn is fully operational, while spindles (used for value-added yarn) capacity is being utilized at around 30%.

	2019	2020	2021	2022
Total number of spindles installed	25,104	25,104	25,104	25,104
Number of shifts worked per day	3	3	3	3
Number of days worked	351	212	304	304
Number of shifts worked	1,053	636	912	912
Average number of spindles worked	25,104	25,104	25,104	25,104
Installed capacity after conversion into 20/S (Kgs)	9,105,878	9,105,878	9,105,878	9,105,878
Actual Production after conversion into 20/S (Kgs)	7,700,310	4,304,430	8,419,482	7,300,000
Actual Production (Kgs)	7,502,922	4,814,966	5,918,399	6,596,618
Total number of rotors installed				1,200
Number of shifts worked per day				3
Number of days worked				106
Number of shifts worked				318
Average number of rotors worked				127,200
Actual production of rotors (Kgs)				917,620

Sector Update

Table 1: Pakistan Export Statistics

	FY20	FY21	FY22	Q1'FY22	Q1'FY23
PAKISTAN EXPORTS (IN USD' MILLIONS)	22,536	25,639	32,450	7,201	7,594
TEXTILE (IN USD' MILLIONS)	12,851	14,492	18,525	4,241	4,777
PKR/USD RATE (AVERAGE)	158.0	160.0	177.5	164.4	229.1

SOURCE: SBP

- Pakistan’s export growth came in at 14% and 27% in FY21 and FY22 respectively. Pakistan’s export proceeds have oscillated in the range of USD 22-25b during the past decade (FY11-FY21), however, in FY22 exports finally grew beyond USD 32.4b.
- In FY22, textile exports were up 28%. Growth in textile exports played a significant role in this uptick, contributing 59% of the overall growth in export base. Share of textile exports in total exports has oscillated in the range of 54-59%, coming in at 57% during the past 3-years (FY20-22).

also hold directorship in M/s Phoenix Chemical (Pvt.) Limited. He holds Master Degree in Mechanical Engineering from Imperial College of Science, Technology and Medicine, London, UK. He is also an MBA (Finance) from Lahore University of Management Science.

- As illustrated in the table below, the composition of textile exports has depicted improvement in the last 3-year period, with contribution from higher value added segment increasing from 77.2% in FY20 to 80.8% in FY22 of aggregate textile exports

Table 2: Segment-wise textile Exports (All Figures in USD' Millions, except for percentages)

	FY20	FY21	FY22	1Q'FY22	1Q'FY23	FY20	FY21	FY22	1Q'FY22	1Q'FY23
HIGH VALUE-ADDED SEGMENT	9,669	12,427	15,605	3,561	3,749	77.2%	80.7%	80.8%	80.6%	81.8%
- KNITWEAR	2,794	3,815	5,118	1,145	1,321	22.3%	24.8%	26.5%	25.9%	28.8%
- READYMADE GARMENTS	2,552	3,033	3,905	861	912	20.4%	19.7%	20.2%	19.5%	19.9%
- BED WEAR	2,151	2,772	3,291	803	780	17.2%	18.0%	17.0%	18.2%	17.0%
- TOWELS	711	938	1,110	241	237	5.7%	6.1%	5.7%	5.5%	5.2%
- MADE-UP ARTICLES (EXCL. TOWELS & BED WEAR)	591	756	848	197	180	4.7%	4.9%	4.4%	4.5%	3.9%
- ART, SILK & SYNTHETIC TEXTILE	315	370	460	108	108	2.5%	2.4%	2.4%	2.4%	2.4%
- OTHERS	555	743	872	206	211	4.4%	4.8%	4.5%	4.7%	4.6%
LOW TO MEDIUM VALUE-ADDED SEGMENT	2,858	2,972	3,717	860	835	22.8%	19.3%	19.2%	19.4%	18.2%
- COTTON CLOTH	1,830	1,921	2,332	557	581	14.6%	12.5%	12.1%	12.6%	12.7%
- COTTON YARN	984	1,017	1,311	289	236	7.9%	6.6%	6.8%	6.5%	5.2%
- OTHERS	43	34	74	14	18	0.3%	0.2%	0.4%	0.3%	0.4%
TOTAL	12,527	15,399	19,332	4,421	4,584					

SOURCE: PBS

- Cotton production in Pakistan, was at its lowest level in decades for FY21, albeit the same posted 18% uptick in FY22. Actual production at 8.33m bales still missed the targeted production of 10.5m bales. Cotton prices rose to a new 12-year high of ~Rs. 21,600/maund as of March'22, as a result of the shortage and higher input costs of fertilizer and energy. Cotton imports were also up 19.8%, in USD terms, for FY22 vis-à-vis preceding year.
- According to United States Department of Agriculture (USDA), the 2022/23 harvested area has declined notably following devastation caused by recent flood in Sindh and Southern Punjab. Hence, the projected production has been brought down to 5m bales. To counter the shortage, import of 5.8m bales is expected during FY23, which is 29% higher than preceding year.

Table 3: Cotton Prices

	FY19	FY20	FY21	FY22
<i>Per Maund (Rs.)</i>	8,770	8,860	13,000	17,380
<i>% Change</i>	26%	1%	32%	34%

- After posting windfall margins in FY21 and H1'FY22, margins of textile operators came under pressure in H2'FY22, mainly on account of higher input costs and recessionary trend in export markets.

Topline growth in FY22 being largely a function of rise in yarn prices. However, economic slowdown in export markets and low capacity utilization levels is likely to have an impact on quantum of sales going forward.

Topline of the company exhibited a significant increase during FY22 and was reported at Rs. 3.9b (FY21: Rs. 2.5b, FY20: Rs. 1.8b) attributable largely to higher average selling price. QTML sells yarn in the local market, a major proportion of which constitutes indirect exports. Customer

concentration is considered to be at a reasonable level, as top 10 customers account for 47% of total revenue.

Due to the elevated inflationary pressure, resultant decrease in purchasing power and high inventories with the retailers there has been a noticeable dip in demand for textile products in the European and American markets. Hence, growth in sales revenue going forward is expected to remain subdued.

Profitability indicators have depicted improvement on a timeline basis; however maintaining the same in lieu of current market dynamics will be important.

In line with the increase in average selling price and higher volumes of sales, improvement was observed in profitability indicators in FY22. Despite a rise in the average cost of raw material, gross margin for the year was reported higher at 8.3% (FY21: 6.0%) translated by higher selling prices. Operating expenses grew in line with revenue. Although finance costs increased as a result of elevated borrowings in FY22, net profit margin increased to 2.9% (FY21: 1.8%). Going forward, sustaining margins at similar levels might be difficult considering subdued demand for textile products. Hence, maintaining the same in line with benchmarks for the assigned ratings is considered important.

Extended working capital cycle in FY22

Cash flows of the company improved during FY22 on the back of higher profitability. However, due to a noticeable increase in the quantum of debt, cash flow coverages went down, albeit remained at reasonable levels. At end-FY22, FFO to Total debt, FFO to Long-term Debt, and Debt Servicing Coverage were reported at 24% (FY21: 55%), 85.2% (FY21: 374), and 2.8x (FY21: 4.6x), respectively. Current ratio stood above 1.0x, while trade debts and inventory provide sufficient coverage against outstanding obligations (1.45x at end-June'22). Given subdued demand, the company is currently holding limited inventory on books to manage working capital cycle. Maintaining liquidity metrics at current levels is critical for debt servicing.

Capitalization indicators have surged over time to finance working capital needs and expansion plans of the company.

During FY22, long-term debt was drawn to finance the capacity expansion in installation of rotors. In addition to that, quantum of short-term borrowings also grew to finance higher working capital requirements. Consequently, at end-June'22, leverage ratio and gearing ratio were reported higher at 2.1x (FY21: 1.0x) and 1.4x (FY21: 0.4x), respectively. Provided no further long-term debt to be drawn over the rating horizon and expected reduction in short-term finances as a part of company's strategy to hold minimal level of inventory, leverage indicators are expected to improve going forward.

ISSUE/ISSUER RATING SCALE &DEFINITIONS

Appendix I

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Short-Term

A-1+

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES					Appendix II
Name of Rated Entity	Quality Textile Mills Limited				
Sector	Textiles				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	RATING TYPE: ENTITY				
	12/30/2022	BBB	A-2	Negative	Maintained
	12/30/2021	BBB	A-2	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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Due Diligence Meeting Conducted	Name		Designation	Date	
	Mr. Tayyab Noor Muhamad		CEO	November 2, 2022	
	Mr. Ali Asghar		CFO	November 2, 2022	